

COMMONWEALTH OF MASSACHUSETTS

DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Petition of Boston Edison Company,)	
Cambridge Electric Light Company and)	
Commonwealth Electric Company d/b/a)	
NSTAR Electric for Approval by the)	
Department of Telecommunications and)	D.T.E. 05-84
Energy of Proposed Revised Tariffs)	
Relating to the Companies' Terms and)	
Conditions for Distribution Services and)	
Competitive Suppliers, Respectively)	

REPLY COMMENTS OF RETAIL ENERGY SUPPLY ASSOCIATION¹

Introduction and Summary of Argument

On December 19, 2005, the Department of Telecommunications and Energy (the “Department”) conducted a public hearing and technical session to consider the petition filed on November 21, 2005 by Boston Edison Company, Cambridge Electric Light Company, and Commonwealth Electric Company d/b/a NSTAR Electric (“NSTAR” and “NSTAR Filing,” respectively) proposing revisions to certain of its tariffs. NSTAR seeks to implement new Terms and Conditions that it claims will solve the problem of load volatility allegedly arising from retail competitive suppliers switching large commercial and industrial (“C&I”) customers onto and off of default service in an effort to “game the system”²

¹ Members of the Retail Energy Supply Association (“RESA”) include Amerada Hess Corporation; Constellation NewEnergy, Inc.; Direct Energy Services, LLC; Reliant Energy Solutions; Select Energy, Inc.; Semptra Energy Solutions; Strategic Energy, LLC; SUEZ Energy Resources NA, Inc. and US Energy Savings Corp. The opinions expressed in this filing may not represent the view of all members of RESA.

² Pre-filed Testimony of James G. Daly, p. 8.

Participating in the December 19 hearing and technical session were NSTAR, other Massachusetts distribution companies, the Regulated Industries Division of the Attorney General's office ("AG"), the Massachusetts Division of Energy Resources ("DOER"), Western Massachusetts Energy Users Coalition, the Retail Energy Supply Association ("RESA"), Direct Energy Services, LLC ("Direct"), TransCanada Power Marketing Ltd. ("TransCanada"), and Select Energy, Inc. Sworn testimony was offered by NSTAR, Direct and TransCanada; RESA's counsel also gave an unsworn statement. Written Comments were submitted that day by RESA, Cape Light Compact ("Compact"), Direct, DOER, The Energy Consortium ("TEC"), TransCanada and The Massachusetts Electric Company d/b/a National Grid ("National Grid") and were followed by Written Comments by the AG on December 20, 2005. At the end of the technical session, the Department encouraged interested parties to submit reply comments that also addressed possible "middle ground" solutions that would minimize the problem of load volatility associated with customer switching.

As discussed in more detail below, the commenters overwhelmingly urge the Department to reject the revised tariffs proposed by NSTAR. Customers and aggregators on one end of the supply chain and retail suppliers on the other universally agree that NSTAR's proposal is unsubstantiated and would harm customers and likely damage the competitive retail market in the Commonwealth - to date, a great success story.³ DOER also strongly agrees with this view.⁴ Indeed, DOER characterizes NSTAR's proposal as "short-sighted,"⁵ and notes that it "poses a

³ Comments of TEC, p. 1; Initial Comments of Compact, pp. 1-2; Initial Comments of RESA, pp. 3-4; Comments of Direct, pp. 2-3; Comments of TransCanada, p. 2.

⁴ Comments of DOER, p. 3.

⁵ Id. at 9.

serious danger to the success of the competitive market” and “smacks of restraint of trade.”⁶

Equally telling is the fact that no wholesale suppliers testified or filed comments in this docket in support of NSTAR’s proposal, even though they are supposed to be the principal beneficiaries of it.

Although NSTAR has not proved that any solution to the so-called load volatility “problem” is needed, RESA, other retail suppliers, and DOER all agree that if the Department wishes to improve the energy markets in a meaningful way, it should adopt hourly pricing for large C&I customers.⁷ That model would eliminate incentives for customer switching to take advantage of differences between default prices and market prices and also foster other important policy goals, as discussed in full in RESA’s December 19, 2005 Initial Comments (“Initial Comments”).⁸ By contrast, NSTAR’s proposed solution will serve no useful purpose and, in the end, will harm the energy markets, undermine established policy and could delay attainment of the desired end state. Consequently, RESA requests that the Department reject NSTAR’s proposal and proceed directly to the implementation of hourly pricing for large C&I customers at the earliest possible date.

⁶ Id. at 7.

⁷ Initial Comments of RESA, pp. 3-4; Comments of Direct, p. 10; Comments of TransCanada, p. 6; Comments of DOER, p. 6.

⁸ Initial Comments of RESA, pp. 14-17.

Argument

I. MOST COMMENTERS AGREE THAT NSTAR HAS NOT MADE ITS CASE

RESA demonstrated that NSTAR failed to prove that load volatility caused any real problem warranting NSTAR's proposed solution or any other remedy for that matter.⁹ In particular, RESA noted that NSTAR failed to prove that:

- Customer switching is due to business practices of retail competitive suppliers that are contrary to statute or Department regulations;
- The increase in wholesale bid prices traces its origin to load volatility associated with switching;
- NSTAR's proposal is necessary to protect those customers that cannot turn to the competitive market for alternative offerings;
- NSTAR's proposal will not harm customers, competitive suppliers and the retail markets.

Five of the seven other entities that filed Written Comments in this proceeding echoed RESA's view.¹⁰

A. Commenters Agree That There is No Evidence that Customer Switching is Due to Business Practices of Retail Competitive Suppliers That Are Contrary to Statute or Department Regulations

At the outset, it is important to note that NSTAR does not claim that customer switching is prohibited by statute or Department regulations. Indeed, James G. Daly, who testified on behalf of NSTAR, readily admits that customer migration "is a basic design feature of Default

⁹ Id. at 6-10.

¹⁰ See Comments of Compact, pp. 1-2; Comments of TEC, pp. 1-2; Comments of DOER, p. 3; Comments of TransCanada, p. 2; Comments of Direct, pp. 2-3. Only National Grid and the AG support the NSTAR proposal, but their advocacy lacks substance. The Comments of National Grid suffer from the same flaw as the proposal itself in that it fails to justify the proposed restriction on customer choice with meaningful statistics and analyses. Similarly, the AG, while reciting verbatim NSTAR's allegations, also fails to provide a statistical basis and a probing analysis that would justify implementation of NSTAR's proposed restriction.

Service”¹¹ Despite that fact, NSTAR wrongly surmises that retail suppliers are improperly switching customers onto and off of default service and, in so doing, are engaged in “unfair manipulation or ‘gaming’ of the system”¹² Like RESA, other commenters overwhelmingly reject that assertion.

RESA noted in its Initial Comments that NSTAR’s allegations fail to recognize that customers move onto and off of default service at their own behest for any number of reasons.¹³ Even the customers themselves acknowledge the truth of that proposition, as evidenced by the comments of TEC:

‘[W]hile NSTAR characterizes customer movement between competitive supply and [Default] Service as supplier “gaming,” there are in fact many reasons why a customer may choose to move back and forth between two retail suppliers. For example, as supply contracts end, it is sometimes not possible to get a new contract in place in time to continue service seamlessly. Accordingly, a customer may wish to go onto [Default] Service for a month or two to give it time to finalize a new contract with the same retail supplier. In addition, with today’s volatile energy prices, short-term contracts (a month or so) are common. With these short-term contracts, there is more customer switching and it is much more likely that a customer will spend time on [Default] Service in between competitive supply contracts. These, like many reasons for switching back and forth, have nothing to do with supplier gaming.”¹⁴

Direct notes, like RESA, that another principal cause of customer switching is the design of the default service rate structure: Direct writes:

The behavior described in the NSTAR proposal is a direct result of the continued presence of utility generation service as a “competitive”

¹¹ Daly Testimony, pp. 5-6.

¹² Id. at 8.

¹³ Initial Comments of RESA, p. 7.

¹⁴ Comments of TEC, pp. 1-2. Unlike NSTAR, National Grid supports an exception to the proposed restriction for customers that wish to switch back to their regular supplier after they move onto default service at the expiration of their retail supply contracts. See Comments of National Grid, p. 2. Thus, even National Grid seems to believe that the NSTAR proposal is overbroad.

offering [D]efault service is no longer serving the purpose for which it was originally intended, that is, to be a “POLR” service, available when customers [lose] their competitive supplier for reasons beyond their control, such as supplier bankruptcy or exit from the market. For smaller customers, it is the service of first rather than last resort. For large customers, who clearly have plenty of options in the competitive market, default service simply acts as another competitive offering, specifically a fully-hedged three-month fixed price. It is no wonder that NSTAR has observed the behavior described in Mr. Daly’s testimony.¹⁵

TransCanada expounds on that theme by noting that customer switching, even if it is facilitated by a retail supplier, does not constitute improper “gaming;” rather, it is a legitimate response to changing prices that is inherent in the existing default service regime:

To the extent that unprecedented market volatility creates a situation where the Default Service rate is favorable, customers and retail suppliers will properly take advantage of the rate. Entering and exiting Default Service flexibly in response to market conditions is not improper “gaming” of the system, but instead is a rational response to market conditions by NSTAR’s customers and their competitive retail suppliers.¹⁶

Finally, RESA noted in its Initial Comments that NSTAR’s proposed solution will not solve the ostensible problem of load volatility.¹⁷ DOER agrees and posits that the NSTAR solution will not eliminate load volatility because customers would remain free to switch to and from default service for any of the foregoing reasons:

NSTAR’s proposal does not eliminate load switching per se. Customers will still be able to return to basic service and jump off basic service to another supplier. Thus, it appears that NSTAR really does not have a problem with load-switching, rather NSTAR has a problem with load switching back to the same supplier.¹⁸

¹⁵ Comments of Direct, pp. 12-13.

¹⁶ Comments of TransCanada, p. 4.

¹⁷ Initial Comments of RESA, pp. 11-12.

¹⁸ Comments of DOER, p. 5.

These comments and others lead to three conclusions. First, NSTAR has not presented any evidence to support its allegations that retail suppliers are engaged in business practices that are contrary to statute or Department regulations. On the contrary, the evidence shows that switching is the exclusive product of customer choice and/or is a legitimate and rational response to changing prices. Consequently, there is no basis for the Department to investigate retail supplier switching patterns or to accept NSTAR's proposed restriction on customer choice. Likewise, the Department should reject Direct's puzzling and unsubstantiated assertion that "it is possible that a handful of competitive suppliers may be engaging in strategic behavior that has a negative impact on default service procurement and pricing" and, therefore, "the Department [should] engage in direct discussions with the three suppliers identified by NSTAR to remedy this behavior."¹⁹ As with NSTAR, Direct fails to provide any evidence of such "strategic behavior," let alone evidence that such behavior, even if it exists, is somehow improper under Massachusetts' statutes or Department regulations.

Second, a leading cause of customer switching is the design of the default service rates. So long as those rates do not reflect real-time market pricing, customers will continue to switch to and from default service. Without timely and accurate price signals, customers cannot begin to learn how to evaluate the broad array of risk-managed products and services offered by competitive retail electricity providers – a process that is a necessary and defining feature of a robust retail market. Even National Grid recognizes that fact, as is evident by its recommendation that the Department eliminate the fixed-price default service option for certain industrial customers.²⁰

¹⁹ Comments of Direct, p. 9.

²⁰ Comments of National Grid, p. 2.

Third, NSTAR's solution will not support the development of the competitive retail electricity market by solving the problem that supposedly inspired it – namely, load volatility associated with customer migration. On the contrary, NSTAR's proposed solution will eliminate customer choice, discourage continued retail market liquidity and, in the end, harm the continued successful development of Massachusetts' retail electricity market.

B. Commenters Agree That NSTAR Has Not Proved That Higher Bid Prices Are Due to Load Volatility Associated With Customer Switching

RESA also argued that NSTAR's evidence was lacking for yet another reason: it did not attempt to quantify the extent to which higher bid prices were caused by load switching versus other factors.²¹ That point was underscored by DOER:

Though NSTAR spends considerable time describing the relationships among volatility, price and switching practices of retail competitive suppliers, there is actually no measurement or quantification of the impact of load volatility on prices. NSTAR does not mention the possibility that other factors may have a much stronger causal affect on [default] service prices than load volatility. Notably, there is no discussion of high and volatile wholesale spot prices (and the underlying volatile natural gas prices), the pricing premiums that may be introduced due to uncertainty in uplift, reliability-must-run (RMR) and procurement of other wholesale-related services and products, and any pricing premiums that may result from exertion of market power among wholesale electricity suppliers. Thus, in terms of an alleged premium, we cannot tell how much of the problem associated with high electricity prices the NSTAR approach seeks to resolve. Though we agree that recent high electric prices are problematic for Massachusetts ratepayers, NSTAR has failed to demonstrate that load switching is the leading cause.²²

What is most interesting, though, are the statistics that were assembled by DOER in an effort to inform the debate in this proceeding. Specifically, DOER plotted default service prices

²¹ Initial Comments of RESA, p. 9.

²² Comments of DOER, p. 3.

against the average Northeastern Massachusetts (NEMA) on-peak, day ahead locational marginal prices (“LMPs”) for a sixteen-month period spanning from July 2003 to November 2005.²³

DOER’s analysis revealed that in most months, default service rates in NEMA were neither much higher nor much lower than the wholesale spot price. In fact, default service prices were, on average, only five percent (5%) higher than wholesale prices during the period studied.²⁴

Although the spread was more pronounced during the two months ended November, 2005, that result is likely attributable to a “Perfect Storm” of factors, including hurricane-related impacts on gas and oil supplies and prices and risk premiums associated with the uncertainty of LICAP, that conjoined during that period to spawn higher bid prices from wholesalers.

In sum, NSTAR failed to prove that load volatility causes bid prices to rise and that the Department must therefore take any corrective action. On the contrary, DOER’s analysis suggests that bid prices have increased for reasons that are unrelated to customer switching. Perhaps that explains why no wholesale suppliers testified at the December 19 hearing or filed comments in support of NSTAR’s proposal.

C. Commenters Agree that NSTAR’s Proposed Solution Would Harm Customers, Retail Competitive Suppliers and the Retail Market

NSTAR’s proposal would injure customers in three ways, all of which would culminate in higher costs, greater exposure to risk and restrictions on desired products and services. First, it would deprive customers of their ability to choose among the already limited group of suppliers that operate in the Commonwealth.²⁵ As such, it would force customers to needlessly invest time and energy in the development of new supplier relationships and potentially deprive

²³ Id. at 5.

²⁴ Id. at 4-5.

²⁵ Comments of TEC, p. 1.

them of access to risk-managed products and services. Second, NSTAR's proposal would hinder customers' ability to react quickly to price changes by easily transitioning to different retail offerings.²⁶ Finally, as DOER notes, it could lead competitive suppliers to add premiums to their customer contracts.²⁷

NSTAR's proposal is equally harmful to competitive suppliers and the retail market because, as DOER observes, it "smacks of restraint of trade and is anticompetitive."²⁸ Indeed, TransCanada posits that such a prohibition "could drive competitive retail suppliers out of the Commonwealth," thereby dampening the vitality of its marketplace.²⁹ What's more, NSTAR's proposal is designed to keep customers on default service instead of encouraging them to turn to the retail market for alternative offerings. It therefore contravenes the Electricity Restructuring Act's³⁰ twin goals of promoting competition and fostering customer choice and is inconsistent with the intended objective of default service for large C&I customers – that is, to be a limited service of last resort.³¹ Perhaps TransCanada put it best when it wrote: "[T]he proposed solution seems to be calculated to do more harm than good to [retail] competition and choice."³² The same holds true for a simple stay that would force customers to remain lodged in default service for a period of time after they return from competitive supply.

²⁶ Id. at 1.

²⁷ Comments of DOER, p. 6.

²⁸ Id. at 7.

²⁹ Comments of TransCanada, p. 3.

³⁰ An Act Relative to Restructuring the Electric Utility Industry in the Commonwealth, St. 1997, c. 164 codified as G.L. c. 164, §§ 1 et seq. ("Electricity Restructuring Act").

³¹ See D.T.E. 02-40-B, p.7.

³² Comments of TransCanada, p. 4.

D. Commenters Agree that NSTAR's Proposal Is Not Necessary to Protect Customers With Limited Retail Supply Options

NSTAR has attempted to justify its ill-conceived proposal on the ground that it is necessary to protect residential and small C&I customers or those that have inferior credit.³³ That is so, NSTAR states, because retail suppliers direct their product offerings to large C&I customers and, therefore, small and less creditworthy customers cannot turn to the retail market for more desirable offerings.³⁴ That premise, too, is flawed.

Both RESA and Direct observe that NSTAR has failed to explain how load volatility in the large C&I customer class affect prices for residential and small C&I customers in light of the fact that NSTAR procures the default service supply for these two groups separately.³⁵ If, however, TransCanada is correct in its assertion that such adverse impact could be attributable to small customers being “inappropriately included as a group to be served by NSTAR in its RFP for large C&I classes,”³⁶ then that is a problem caused by NSTAR itself, not by retail suppliers.

NSTAR's argument that its proposed restriction is needed to protect less creditworthy customers because they lack retail supply options does not fare any better. As both RESA and TransCanada note, these customers can readily receive competitive product offerings by posting security or making advance payments.³⁷ Hence, it simply is not true that NSTAR's proposal or any other solution is necessary to protect small and less creditworthy customers.

³³ Daly Testimony, pp. 8-9.

³⁴ Id. at 8.

³⁵ Initial Comments of RESA, pp. 9-10; Comments of Direct, p. 5.

³⁶ Comments of TransCanada, p. 6.

³⁷ Initial Comments of RESA, p. 10 n. 24; Comments of TransCanada, p. 5.

II. The Department Should Proceed Directly to Hourly Pricing

The foregoing discussion illustrates that customers, retail suppliers and DOER universally agree that NSTAR has not made its case for its proposed prohibition on a customer's contact with its existing supplier. Indeed, these commenters maintain that NSTAR has not even proved that load switching is causing a problem that warrants any solution by the Department. Despite that fact, Department staff conveyed the perception at the December 19 public hearing and technical session that it wished to consider middle-ground solutions that would immediately curtail load volatility associated with customer switching. Because there is no real evidence that a load volatility problem exists and such solutions could harm the competitive retail market, RESA urges the Department to proceed directly to hourly pricing.

RESA, Direct, TransCanada and, most notably, DOER all contend that if the Department wishes to alter the default service paradigm to the benefit of consumers and the marketplace, hourly pricing is the right solution. That is because it not only would eliminate incentives for customer switching, but it also would foster other worthy policy goals. These include, among others, the advancement of demand response and improvement to wholesale market performance that would benefit all customers. An hourly pricing model is destined to be a sure winner, as evidenced by the experience of states that have adopted it, most notably, New York, New Jersey and Maryland. Furthermore, as DOER makes clear, the Department's commitment to adopt hourly pricing dovetails with the mandate of the Federal Energy Policy Act of 2005,³⁸ which directs each state to investigate and opine on whether it is appropriate for it to adopt time-based pricing and other demand response programs.³⁹ RESA therefore urges the Department to

³⁸ P.L. 109-58, § 1252(a)(F).

³⁹ Comments of DOER, p. 8.

proceed toward the implementation of hourly pricing for large C&I customers at the earliest possible date.

Conclusion

Massachusetts, unlike most other states, has successfully implemented competitive retail markets due largely to the vision and leadership of the Department. RESA, like DOER and other commenters, urges the Department to reject NSTAR's proposed tariffs because they are unwarranted and would harm customers, suppliers and the retail market. RESA does recommend, however, that the Department open a docket immediately to commence working toward the implementation of hourly pricing for large C&I customers, which most commenters agree is the best way to improve the energy markets of the Commonwealth. RESA appreciates the opportunity to participate in this important proceeding.

Respectfully submitted,

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DATED: December 29, 2005

DN 321520